APPENDIX
to
Petition for Writ of Certiorari

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PRESENT: Carrico, C.J., Cochran, Poff, Compton, Thompson, and Stephenson, JJ., and Harrison, Retired Justice

UNITED VIRGINIA BANK/NATIONAL, ET AL.

-v-

RECORD No. 790777

OPINION BY JUSTICE W. CARRINGTON THOMPSON

STEPHEN L. BEST, ET AL
January 22,1982

FROM THE CIRCUIT COURT OF FAIRFAX COUNTY
Richard J. Jamborsky, Judge

In the companion case of *Lipps* v. *First American Service Corporation*, ...Va. ....., ... S.E.2d..... (this day decided), we held that a due-on-sale acceleration clause in a security deed of trust is not an unreasonable restraint on alienation in Virginia. The lower court in this case decided to the contrary and held that the lender did not have the option to activate the acceleration clause unless it could prove that the security for its obligation was impaired. We disagree with that conclusion and reverse the judgment of the trial court.

In August, 1972, Edward and Anna Firth (Borrowers) acquired property in Fairfax County. To obtain the requisite purchase money, Borrowers executed a promissory note, dated September 25, 1972, payable to United Virginia Bank/National (Lender) for the amount of $66,800, with interest thereon at the rate of seven-and-one half percent per annum. Borrowers also executed a deed of trust conveying the subject property to secure payment of that note. The deed of trust provided in pertinent part:

> And the said parties of the first part, *in order more fully to protect the security of this Deed of Trust*, do hereby agree as follows:
>
> . . . .

> 7. The maker of the note covenants and agrees that he will not assign or transfer the property secured by this deed of trust without prior approval of the noteholder. [Emphasis added.]

The deed of trust also provided that "[s]hould there be a failure to keep and perform the aforesaid covenants or any of then . . . then the indebtedness hereby secured, both principal and interest shall immediately become due and payable."

On March 21, 1978, Stephen and Letty Best (Purchasers) contracted to purchase the property. On March 23, the Purchasers wrote the Lender requesting consent to the transfer as per the deed of trust and requesting information on an assumption. Lender replied on March 29, 1978, that it would consider an assumpiton but not at a seven-and-one-half percent interest rate. Lender notified Purchasers by letter dated April 24, 1978, that it would allow an assumption at nine-and-one-quarter percent. On May 31, 1978, Borrowers, without Lender's approval, conveyed the subject property by deed "subject to a note secured by a deed of trust." Purchasers notified Lender of the transfer and tendered the June installment. Lender returned Purchasers' check by letter on June 21,1978, and offered the Purchasers the nine-and-one-quarter percent assumption with a one point assumption fee, leaving the offer open until July 10, 1978. On July 21, 1978, Lender notified the Borrowers that "under the terms of the Deed of Trust the balance is due in full."

On July 3, 1978, Purchasers filed a bill for declaratory judgment in the lower court seeking judgment that (1) the provision in the deed of trust requiring approval by noteholder of the transfer be declared null and void; (2) alternatively, if said provision be valid, that consent not be unreasonably withheld and that the requirement as condition to approval of an increase in interest and one percent assumption fee be declared unreasonable; and (3) that the Lender be required to accept payments from the Purchasers.

After hearing evidence *ore tenus* and considering memorando filed, the lower court entered its final decree on February 22, 1979, finding, relevant to this opinion, that the provision in question constituted a restraint on alienation and that the restraint was unreasonable because the bank had failed to show that enforcement of the provision was necessary to protect its security.

Purchasers would have us construe the prefatory language of the deed of trust, "[a]nd the said parties of the first part, in order more fully to protect their security of this Deed of Trust, do hereby agree as follows," as a limitation or restriction on the triggering of Covenant 7. Under this theory before a lender could avail itself of the use of the acceleration clause, it would be compelled to show that its security had been impaired or its risk in the obligation increased. If this were true, lenders in each and every case, as a practical matter, would have to resort to litigation to activate an acceleration clause because impairment of security or increase of risk would entail factual-values judgments which only a court could provide. We do not believe this result was contemplated in the execution of the deed of trust.

If this result were intended, it would have been a simple matter to have made the proper insertion in Covenant 7. The prefatory clause quoted above comes within the description of a preamble, a recital, or a purpose clause. Under settled rules of construction, if the prefatory or recital language conflicts with the obligatory provisions of the contract, then the obligatory provisions must prevail. *Scott v. Albemarle Horse Show*, 128 Va. 517, 526, 104 S.E. 842, 845 (1920). *See also Jamison* v. *Franklin Life Insurance Co.*, 60 Ariz, 308, 317, 136 P.2d 265, 269 (1943); *Schmitt* v. *Wright*, 317 Ill. App. 384, 398, 46 N.E.2d 184, 191 (1943); *Hulin* v. *Veatch*, 148 Or. 119, 35 P.2d 253 (1934); and *Martin* v. *Rothwell*, 81 W.Va. 681, 95 S.E. 189, 190 (1918).

We hold that Covenant 7 of this deed of trust was not modified by the prefatory language described herein and

that to invoke Covenant 7 Lender did not have to allege or prove that the transfer of property impaired its security or increased its risk.

For the foregoing reasons, the judgment appealed from will be reversed and judgment entered for the appellants.

Reversed and final judgment.

VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Friday, the 12th day of March, 1982. United Virginia Bank/National, et al., Appellants, against Stephen L. Best, et al., Appellees.

Record No. 790777

Circuit Court No. C-58379

Upon a Petition for Rehearing

On consideration of the petition of the appellees to set aside the judgment rendered herein on the 22nd day of January, 1982, and grant a rehearing thereof, the prayer of the said petition is denied.

A Copy,
Teste:
s/ALLEN L. LUCY
Clerk.

VIRGINIA:

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

STEPHEN L. BEST, ET AL.,
Plaintiffs,

vs.

UNITED VIRGINIA BANK/NATIONAL, ET AL.,
Defendants.

IN CHANCERY NO. 58379

FINAL DECREE

This cause came on to be heard on the 12th day of December, 1978, upon the papers formerly filed herein, evidence taken *ore tenus,* memoranda of law submitted by counsel for the parties and argument of counsel.

And it appearing to the Court that on September 25, 1972, the plaintiffs Edward E. Firth and Anna Westwood Firth conveyed certain property to George D. Hicks, Jr. and John H. Rust, Trustees, by deed of trust recorded in Deed Book No. 3700, page 609 of the land records of Fairfax County, Virginia, to secure unto United Virginia Bank of Fairfax, predecessor-in-interest to the defendant United Virginia Bank/National, the payment of a promissory note, dated September 25, 1972, in the sum of $66,800.00, with interest thereon from date at the rate of 7.5 per cent per annum.

And it further appearing to the Court from the Deed of Trust that "in order more fully to protect the security of the Deed of Trust" paragraph 7 of the Deed of Trust provides in part that "The maker of the note covenants and agrees that he will not assign or transfer the property secured by this deed of trust without prior approval of the noteholder," and that the deed of trust further provides that "Should there be a failure to keep and perform the

aforesaid covenants, or any of them, . . . then the indebtedness hereby secured, both principal and interest, shall immediately become due and payable. . . ."

And it further appearing to the Court that on March 23, 1978, the plaintiff Stephen L. Best requested the consent of the defendant to the conveyance of the property by the plaintiffs Edward E. Firth and Anna Westwood Firth to the plaintiffs Stephen L. Best and Letty Sheild Best, who desired to take over the payment of the note secured by the deed of trust.

And it further appearing to the Court that on March 29, 1978, the defendant United Virginia Bank/National advised the plaintiff Stephen L. Best that it would consider the assumption of the "real estate loan" secured by the deed of trust but that it would not be assumable at an interest rate of 7.5 per cent.

And it further appearing to the Court that on May 31, 1978, the plaintiffs Edward E. Firth and Anna Westwood Firth, without the prior approval of the noteholder, conveyed the property to the plaintiffs Stephen L. Best and Letty Sheild Best by deed recorded in Deed Book No. 4886, page 177 of the land records of Fairfax County, Virginia, the conveyance being made subject to the promissory note.

And it further appearing to the Court that the aforesaid clauses of the deed of trust constitute a restraint on alienation, to which finding the defendants United Virginia Bank/National and United Virginia Mortgage Corporation, by counsel, note their exceptions on the grounds that the same is contrary to the law and the evidence presented in the above-styled matter.

And it further appearing to the Court that the restraint on alienation is unreasonable because the defendant United Virginia Bank/National has failed to show that the enforcement of the aforesaid clauses of the said deed of trust was necessary to protect its security, to which finding the de-

fendants United Virginia Bank/National and United Virginia Mortgage Corporation, by counsel, note their exceptions on the grounds that the same is contrary to the law and the evidence presented in the above-styled matter.

And it further appearing to the Court that the plaintiffs Stephen L. Best and Letty Sheild Best were willing and wanted to assume the obligation to pay the note secured by the deed of trust, to which finding the defendants United Virginia Bank/National and United Virginia Mortgage Corporation, by counsel, note their exceptions on the grounds that the same is contrary to the law and the evidence presented in the above-styled matter.

And it further appearing to the Court that the sole reason for the defendant United Virginia Bank/National's refusal to approve transfer of ownership and assumption of the note was to obtain an increase in the rate of interest and a one per cent transfer fee, to which finding the defendants United Virginia Bank/National and United Virginia Mortgage Corporation, by counsel, note their exceptions on the grounds that the same is contrary to the law and the evidence presented in the above-styled matter.

And it further appearing to the Court that Virginia is a deed of trust State, and that if defendant United Virginia Bank/National wanted to reserve the right to increase the interest rate, the provision could have been specifically stated in the deed of trust, and that the parties thereto could have contracted for such a provision and that their failure to do so leads the Court to conclude that the plaintiffs are entitled to the relief prayed for, to which finding the defendants United Virginia Bank/National and United Virginia Mortgage Corporation, by counsel, note their exceptions on the grounds that the same is contrary to the law and the evidence presented in the above-styled matter.

And it further appearing to the Court that the aforesaid findings are limited to the narrow facts of this case and the deed of trust in this case.

UPON CONSIDERATION WHEREOF, it is, therefore, ADJUDGED, ORDERED and DECREED that the aforesaid provisions of the deed of trust recorded in Deed Book No. 3700, page 609 of the land records of Fairfax County, Virginia, constitute a restraint on alienation.

And it is further ADJUDGED, ORDERED and DECREED that the restraint on alienation is unreasonable because the defendant United Virginia Bank/National has failed to show that enforcement of the aforesaid clauses of said deed of trust was necessary to protect its security.

And it is further ADJUDGED, ORDERED and DECREED that Edward E. Firth and Anna Westwood Firth had the right to convey ownership of their property to Stephen L. Best and Letty Sheild Best upon the conditions as set forth in the deed from the Firths to the Bests, and that United Virginia Bank/National is obligated to accept payments on the note from the Bests in accordance with its terms, without any increase in the interest rate and without the payment of a one percent fee.

And it is further ADJUDGED, ORDERED and DECREED that the transcript of the hearing before this Court is directed to be made a part of the record in the above-styled matter, provided the transcript is filed in the office of the Clerk of this Court within 60 days of the entry of this Final Decree.

AND THIS DECREE IS FINAL.

ENTER: February 22, 1979

Date: February 22, 1979 /s/ RICHARD J. JAMBORSKY,
Judge

EXCERPTS FROM PETITION FOR REHEARING

II. *IF THE COURT INTENDS TO BASE ITS DECISION ON THE PRINCIPLE THAT THERE IS A CONFLICT BETWEEN THE RECITAL LANGUAGE AND THE OBLIGATORY LANGUAGE IN THE DEED OF TRUST, THE BESTS AND THE FIRTHS SHOULD HAVE AN OPPORTUNITY TO BRIEF AND ARGUE THE APPLICATION OF THIS PRINCIPLE TO THE FACTS.*

Rule 5:42(e) of the Rules of the Supreme Court of Virginia provides that the opening brief of appellant shall contain "the principles of law, the argument and the authorities relating to each question presented." Rule 5:43(d) provides that the brief of appellee shall contain the principles of law, the argument, and the authorities relating to each question presented by appellant.

The Court ruled that the obligatory language of covenant 7 conflicted with the preamble which states the purpose of the covenant, and, therefore, the obligatory language must prevail. This principle of law was not presented in Appellant's Brief and was never advanced by the Lenders in any earlier proceeding, and, therefore, it was not addressed in Appellees' Brief and was never argued on their behalf. It came as a complete surprise.

The one question considered in the *Best* opinion was decided on a ground not raised and cases not cited in either brief. Purchasers should have the opportunity to brief and argue this principle and its application to the facts.

III. *THE LEGAL PRINCIPLE ADOPTED BY THE COURT SHOULD NOT HAVE BEEN APPLIED IN THIS CASE*

[Argument follows.]

IV. *A DECISION IN THIS CASE THAT THE COVENANT OVERRIDES THE PREAMBLE BECAUSE OF A CONFLICT IN THE TWO PROVISIONS RESULTS IN PERMITTING THE LENDER TO INVOKE AN UNLIMITED AND UNRESTRICTED RESTRAINT ON ALIENATION, WHICH IS CONTRARY TO THE LAW OF VIRGINIA AND THE CONSTITUTION OF THE UNITED STATES.*

If the Court decides that the two provisions in question cannot be harmonized, then it must conclude that covenant 7 is an unlimited and unrestricted restraint on the Borrowers' right to convey title. It has never been submitted as a principle of law by the Lender, and it would be ludicrous to argue, that an unlimted or unrestricted alienation on the restraint of title is lawful. Such is clearly contrary to the laws of Virginia and the Constitution of the United States.

In *Dunlop* v. *Dunlop's Executors*, 144 Va. 297, 308, 132 S.E. 351 (1926), the Court said:

> It is unnecessary to go into at length the well-known doctrine that neither a testator in a will nor a grantor in a deed can give a fee simple estate in either real or personal property and endeavor to impose upon the donee any condition incompatible with the usual and necessary incidents accompanying a fee simple estate. Among such incidents are the complete right of alienation, without let or hindrance and the liability of the property for the debts of the donee.
>
> . . . it is well settled in this country and in England, from which country we derive the principles of our jurisprudence, that a gift or grant of a beneficial estate, in fee or absolutely, whether legal or equitable, has certain legal incidents of which the estate cannot be divested, and all conditions adopted for that purpose are

> necessarily repugnant, and void. Among those incidents are the donee's or grantee's power of alienating such estate, and its liability for his debts
>
> . . .
>
> The reason for this doctrine or principle is the repugnancy of such restraints upon the ordinary rights of property, and that property would thereby be withdrawn from the ordinary rules and channels of commerce and trade.

In *Terrace* v. *Thompson*, 263 U.S. 197, 68 L.ED. 255, 44 S.Ct. 11 (1923), the Supreme Court of the United States stated:

> The 14th amendment, as against the arbitrary and capricious or unjustly discriminatory action of the state, protects the owners in their right to lease and dispose of their land for lawful purposes . . .

Clearly, §55-59 of the Code of Virginia cannot be interpreted to permit a secured lender to enforce any covenant it chooses to put in its deed of trust. The covenant may not violate the legal rights of a borrower, including his constitutional rights. It was never submitted as a legal principle by the Lender that it had such right. However, if the Court applies the legal principle that there are conflicting provisions which cannot be harmonized, it must find that the covenant, which is unlimited and unrestricted, can be enforced for any purpose. Such a covenant is a flat restraint on alienation, and is unconstitutional.

Under the language of the deed of trust in question, if covenant 7 can be enforced, it can only be enforced in one of two ways:

1. For any purpose, which would amount to a flat restraint or alienation, and would be unlawful; or

2. For the purpose stated in the preamble, and that purpose only, which would preclude enforcement for the purpose of increasing the interest rate.

Under either interpretation, the decision of the trial court should be affirmed.

EXCERPT FROM BRIEF OF APPELLANTS' Page 28.

The preamble to that portion of the Deed of Trust which contains Paragraph 7 provides that the covenant in question was given "in order more fully to protect the security of this Deed of Trust." A at 96. It is clearly evident that the clauses in question protect the security of the Deed of Trust by assuring payment of the debt. As was stated by the Court in *Stith* v. *Hudson City Savings Institution*, 63 Misc. 2d 863, 313 N.Y.S.2d 804 (1970),

> Acceleration provisions in mortgages are intended and designed *for the protection of the mortgagee and to make the security more effective* and such was the purpose of the clause under consideration. It is common knowledge that "due-on-sale" provisions similar to that here employed are often insisted on by loaning institutions. They thereby reserve to themselves the right in the event of sale, to determine whom they wish to accept as a debtor and owner of the security, and to reappraise the desirability of the loan originally made from the standpoint of the then value and condition of the security covered and the interest rate obtainable in the current money market. . . . 313 N.Y.S.2d at 808 (citations omitted) (emphasis added).